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December 2, 2016

Via Email: KlintKesto@house.mi.gov; HankVaupel@house.mi.gov; BrandtIden@house.mi.gov

Michigan House Judiciary Committee
Representative Klint Kesto
Representative Brandt Iden
Representative Henry Vaupel

Re: House Bill No. 4919 (2015)

Dear Representatives:

As you may recall from prior correspondence, I am a practicing attorney of over 46 years, during which time my specialty has been condominium law and practice. I was a co-draftsperson of the 1978 Michigan Condominium Act as well as a significant contributor to the 2001-2002 amendments to the Act.

I understand that HB 4919 is on the committee's schedule for consideration next Tuesday, December 6. I request that this letter be read into the record at your December 6 meeting. As you may be aware, I have been requesting for some time that Representative Kesto move forward with the bill, as I fully support the original language as presented to the committee in September 2015.

That being said, it has now come to my attention that due to pressure from anti-consumer special interest groups, the committee may soon consider a revision of HB 4919 that may specifically allow the anti-litigation provisions in question to remain effective with respect to lawsuits against developers. This change would be unconscionable for several reasons, and if implemented by the committee in a revision of HB 4919, I would be forced to withdraw my support entirely and inform Board members of condominium associations and others across the state to contact you immediately in opposition to the bill.

Part of the reason for raising this alarm at this early stage while the bill is still in committee is that I remember too well what happened during the prior lame duck session in 2014, when significant and egregious changes to the Nonprofit Corporation Act were rushed through the legislature with little chance for public comment or proper consideration. I am again enclosing my published article on that topic for your reference and for those who are copied on this correspondence.

The prospective change would eviscerate the bill, particularly because most Bylaws containing the anti-litigation provisions in question already state that the provisions do not apply to collection of assessments or enforcement of Bylaws. Provisions in governing documents requiring approval by co-

owners for litigation are drafted and designed by developers to minimize the chance they will face a suit arising from construction defects.

If, in fact, the prospective changes are incorporated in HB 4919, circumstances will be worse than they are now. To begin with, *Tuscany Grove Association v. Peraino* 311 Mich App 389; 875 NW2d 234 (2015), failed to recognize that the anti-litigation provisions in question are unconscionable. The decision confirmed, for the time being, that provisions requiring 2/3 approval of litigation are recognized by the courts as reasonable and that they control over the board's authority to enforce the governing documents on behalf of the association, which rather should, by any reasonable interpretation, include litigation when necessary. Since there is currently no statutory provision regarding the prohibition of the commencement of litigation in the Michigan Condominium Act, any limitation with respect to developers on the full correction of that Court of Appeals decision through the proposed legislation would result in the **codification of a law which would further establish recognition of these provisions as reasonable with respect to developers.**

In conclusion, I implore you to consider your constituents' consumer rights, rights of access to the courts, and basic common sense, which should lead you to conclude that the kinds of anti-litigation provisions drafted by developers for their own benefit have nothing to do with protecting the financial interests of co-owners, and legislative action is sorely needed to correct this situation. Indeed, an appellate court in New Jersey essentially laughed off developers' professed concern for co-owners' financial interests in this respect (emphasis added):

> "Moreover, despite their **disingenuous expressions of concern** for the owners' financial interests, defendants have no standing to enforce the unit owners' rights [to litigation approval] under the by-laws."[1]

I hope the foregoing will lead you to make the right decision and move forward with the original language of HB 4919.

Very truly yours,

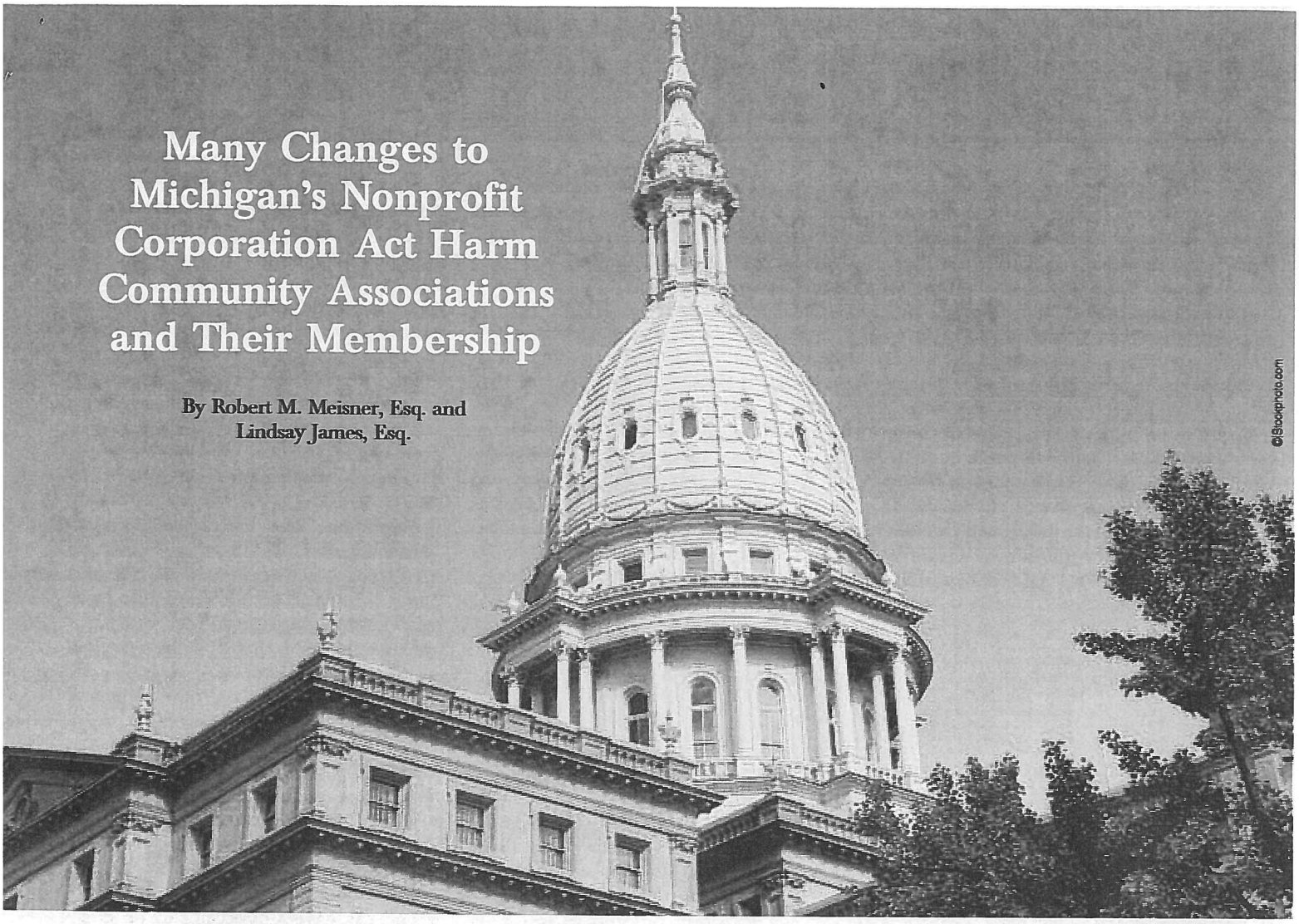
THE MEISNER LAW GROUP, P.C.

Robert M. Meisner

RMM/MAP
Encl.

cc: Jim Ananich, Senate Democratic Leader; Tim Greimel, House Democratic Leader; Sam Singh, House Democratic Leader-Elect (via email w/ encl.)

[1] *Port Liberte II Condominium Ass'n, Inc. v. New Liberty Residential Urban Renewal Co.* 435 N.J.Super. 51 (2014)



Many Changes to Michigan's Nonprofit Corporation Act Harm Community Associations and Their Membership

By Robert M. Meisner, Esq. and Lindsay James, Esq.

Michigan residents who live in condo/homeowner/cooperative associations and who have ties or dealings with nonprofit corporations were recently dealt a serious blow by lawmakers. Most attorneys who specialize in this area of the law were themselves surprised to learn that significant changes were made to the Michigan Nonprofit Corporation Act (the "Act") during a lame duck December 2014 session of the Legislature. Although some changes can be viewed as positive (such as electronic voting), as a general matter, the changes have a negative impact. This matters a great deal in the legal profession, as most every community association is organized as a nonprofit corporation, so these changes affect our collective interests and the clients we represent. Below are some of the highlights (or actually, the lowlights).

One of the most troubling changes is the addition of Sec 122(3) to the Act, which provides: "The uniform fraudulent transfer act... does not apply to distributions permitted under this act." The uniform fraudulent transfer act is designed to prevent debtors from defrauding creditors by transferring assets to a third party (generally an affiliated or related company or individual) without getting "reasonably equivalent value" in exchange. In other words, it prevents a company from giving away its assets so that it would become impossible to collect a judgment against it (i.e., to become "judgment-proof"). This is bad policy because it makes it easier for nonprofits to defraud others. This seems to be confirmed by the newly-added Section 753, which states that a nonprofit may "dispose of all, or substantially all, of its property and assets... in a transaction that is not in the usual and regular course of its business, on any terms and conditions and for any consideration" (emphasis added). Therefore, the nonprofit can transfer all of its assets for no justifiable reason and receive virtually nothing in exchange. Section 753 still requires member approval for such an action, but the Board has the right to determine that "special circumstances" exist to avoid membership approval. But fundamentally, what possible legitimate reasons are there for allowing any company to do this, let alone nonprofits which are intended to be established for the greater good?

In addition, the revisions to Section 209 of the Act allow a corporation to unduly protect its directors – not just the uncompensated but also the compensated – from liability for virtually any sort of conduct other than, principally, crimes and intentional infliction of harm. The changes, for example, delete what used to be a gross negligence exception, whereby directors were not shielded from actions that were grossly negligent (generally, some conduct between negligence and intentional – often called recklessness). No more, however. Our lawmakers saw fit to make sure there are no remedies for citizens when directors are grossly negligent. In fact, directors may be immune from liability for anything (i.e., any act or omission) other than conduct which amounts to "intentional

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infliction of harm on the corporation, its shareholders, or members." This is a very high standard, particularly considering that a director's wrongdoings can inflict harm on the association or charity without having the intent to inflict harm.

While there is a logical reason for protecting volunteer directors who might otherwise be reluctant to serve, there is no reason to protect compensated nonprofit directors more than compensated profit corporation directors. Put another way, what is the justification for allowing directors to be compensated for their services and allowing them to escape liability for the service for which they are being compensated? Who benefits from this – seemingly no one other than malicious and/or negligent directors (and, collaterally, insurance companies which avoid having to pay claims). While there is an inherent tension between wanting to encourage qualified people to service as directors on the one hand, and holding directors accountable for the protection of the shareholders on the other hand, our lawmakers have swung the pendulum too far in favor of directors. Prior protections in the Act were adequate.

Even worse, Subsection 2 of Section 209 arguably automatically foists these new provisions on nonprofit corporations that already have a limitation on director liability in their Articles of Incorporation. This is despite the fact that existing limitations in a corporation's Articles are typically more limited and more reasonable than what the amended Act provides. The amendments, therefore, may saddle nonprofits with these new provisions whether they want them or not. Alternatively, it may force nonprofits to incur legal fees and go through the difficult process of amending association documents in order to enact amendments so that the new provisions are not automatically forced on them.

Even if the changes are not automatically imposed on nonprofit corporations, directors and officers are now further insulated because, under Section 541, in discharging their duties, a director or officer is entitled to rely on information, opinions, reports, or statements, including financial statements and financial data, if they are prepared or presented by another director, officer, or employee of the nonprofit corporation, so long as the director or officer "reasonably believes [the other director or officer] to be reliable and competent in the matters presented." It makes sense for directors and officers to rely on the advice of third party legal counsel, accountants, engineers, or other professionals, but now they can rely on each other so long as they reasonably believe the information to be reliable and competent. This will not benefit the members of the nonprofit because the advice of third party professionals is designed to help the directors and officers make better decisions. Should directors and officers not seek that expert advice, they will have a new tool to defend against a claim by members that fiduciary duties were breached.

This can have a direct impact on directors who also provide services to the nonprofit, such as the case involving homeowners associations. For a variety of reasons, we generally counsel against directors performing services for the association, as the wearing of "two hats" so to speak often leads to conflicts of interest, poor oversight, and a host of other unforeseen problems. In addition, we would recommend that the dual-role director not only provide full disclosure to the rest of the directors but that he exclude himself from the decision-making process where his dual-role interests may be affected. The Act, however, does not mandate that he be excluded, and now, theoretically, the Board can rely on the so-called expertise of the director who already has some self-interest in performing services for the association.

In the area of condominium development, the limited liability provisions are even more problematic. Developers initially establish the condominium association as a nonprofit corporation. Developers appoint the initial board of directors – obviously only those who are friendly and/or affiliated with the developer. The developer's appointees remain in control of the

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board of directors and of the corporation until the "transitional control date," which occurs when at least half of the condominium units in the project are sold, a process which can take years. During this time, there exists a setup and circumstance where the developer will protect its interests vis-à-vis the nonprofit association that the developer has set up. Now with the new provisions enacted by the Legislature, the fox will really be watching the henhouse. There is no question that developers are going to utilize these new provisions to protect their appointees to condominium boards from liability for wrongful acts. It would seem to give them license to mismanage the corporation and otherwise fail to exercise sound business judgment with impunity. So that when the turnover of power to the owners and buyers of the condominiums is made – a time when the new board or directors should closely examine what the developer has done during its management of the nonprofit – they will have a much more difficult time holding developers and their designees on the board accountable for mistakes and mismanagement. The lawmakers were certainly looking out for developers of condominium projects and insurance companies. But who else? Certainly not the thousands of members of the hundreds of associations across this state.

The amendments to Section 408 also permit directors to be elected without a meeting of the members or shareholders under a specified ballot process, making it potentially easier for incumbent directors to remain in power without debate and without nominations for opposition following that debate. Indeed, the amendments refer to "any action the shareholders or members are required or permitted to take at an annual or special meeting," not just election of directors, so this provision may be subject to abuse.

The revisions also permit the addressing and passing of certain matters at membership meetings without prior notice and conducting "membership" meetings without notice. In addition, under Section 209, "other persons" (i.e., those other than the duly elected directors) are authorized to exercise corporate powers or manage the business and affairs of the corporation. The same section generally relieves elected directors of their responsibilities to the extent of the delegation, yet still insulates such other persons to the extent the elected directors would also be protected. These are people who potentially have no stake in the community – yet they could be entrusted with managing the affairs of the community, and generally with impunity. This takes away the members' right of self-governance to elect the people they want to control the corporation.

The new law also makes derivative actions harder to file. These are actions when a shareholder sues on behalf of the corporation in order to bring the corporation into compliance with its governing documents through a court action. Under the new Section 491a, et. seq., there is an automatic (and seemingly arbitrary) 90-day pre-suit waiting period, along with provisions providing for dismissal of the lawsuit at early stages when certain combinations of the existing directors think the lawsuit should be dismissed. This used to be a heavy tool for shareholders/members to make sure directors complied with governing documents. It has now become that much tougher to bring these suits, particularly for those who are already disadvantaged because the board of directors has attorneys and community funds at its disposal. Insurance companies were likely pleased with the addition of this section, which, along with Section 209, will mean they will be less likely to be obligated to tender a defense to derivative claims. We will not hold our breath, however, waiting for insurance premiums to go down.

While the law may have been intended to improve efficiency

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in the operation of nonprofits, the law goes too far, resulting in consequences that are harmful to the public and the members and shareholders of nonprofit corporations, particularly those living in neighborhoods governed by community associations.

Apparently too many were asleep at the legislative wheel and a serious wreck has occurred. We believe the Legislature should repeal these and other negative aspects of the Act. We hope the CAI-Michigan community will support this effort and that we, as a group, have a serious and ongoing dialogue about these issues and work with our legislature and the Governor to come up with better solutions for nonprofit corporations in the state. ■

Robert M. Meisner, is a practicing attorney of over 44 years and founding member of the Bingham Farms law firm of The Meisner Law Group, P.C., 248-644-4433, www.meisner-law.com. He is a Fellow of and Michigan's first inductee into CAI's College of Community Association Lawyers (CCAL). He has been selected five times as a Michigan Super Lawyer, twice a Top Metro Detroit Attorney in the field of Condominium Law and Real Estate Law by dbusiness Journal, and has been honored as one of only 30 distinguished lawyers to the 2014 Michigan "Leaders in the Law" by Michigan Lawyers Weekly. Robert Meisner is co-draftsperson of the 1978 Michigan Condominium Act and contributor to the 2001-2002 Amendments thereto.

Lindsay James is a practicing attorney of over ten years, and an associate attorney at The Meisner Law Group, P.C., 248-644-4433, www.meisner-law.com. Ms. James specializes in condominium law, commercial and civil litigation, and transactions, including representing the interests of community, condominium, and homeowner associations in state, federal, and appellate courts.

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Michigan House Judiciary Committee
Representative Klint Kesto
Representative Brandt Iden
Representative Henry Vaupel

Re: House Bill No. 4919 (2015)

Dear Representatives:

I wish to supplement my prior letter of today's date by explaining how *Tuscany Grove v. Peraino* has negatively impacted the civil rights of one of my firm's clients, Fieldstone Village Association, where the overwhelming majority of the community members are African-American. In *Fieldstone Village Association v. Fieldstone Village Development, LLC* in the 6th Judicial Circuit Court of Oakland County, Case No. 2016-152288-CB, we sought to hold the developer responsible for racial discrimination, among other things, but the circuit court judge pointed to the *Tuscany Grove* decision in dismissing the claim for failure to secure litigation approval from the members of the Association. This is another example of how these ill-conceived anti-litigation provisions are applied by the courts with wide-ranging consequences, including consequences for equality and human rights.

Please be advised that I have forwarded my prior letter of today's date, as well as this letter, to the Michigan Chapter of the American Civil Liberties Union.

Very truly yours,

THE MEISNER LAW GROUP, P.C.

Robert M. Meisner

RMM/MAP

cc: Jim Ananich, Senate Democratic Leader; Tim Greimel, House Democratic Leader; Sam Singh, House Democratic Leader-Elect; Michigan Chapter, American Civil Liberties Union (via email)